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CASES CITED

In the Supreme Court of the United States

OCTOBER TERM, 1971

No. 1331

AFFILIATED UTE CITIZENS OF THE STATE OF UTAH, et al,
Petitioners,

vs.

UNITED STATES, et al,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY OF RESPONDENTS, FIRST SECURITY BANK OF UTAH, N.A., JOHN B. GALE AND VERL HASLEM TO THE AMICUS CURIAE BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION

ARGUMENT

The Government's brief, commencing at page 51, includes a segment written by the Securities and Exchange Commission seeking to impose liability on the Bank in order to lengthen the tentacles of 10b-5 and simplify the Securities and Exchange Commission's task of prosecution under that regulation. Primarily, it appears

the Securities and Exchange Commission wants this Court to eliminate proof of reliance as an element in all 10b-5 cases, public or private.

Securities and Exchange Commission counsel commences with the statement:

> "With respect to the Rule 10b-5 claims against these defendants, the parties are in apparent disagreement about the underlying facts and the accuracy of the findings of fact by the district court. The Commission's concern, however, is with Rule 10b-5. This portion of the brief therefore deals solely with the proper interpretation and application of that provision in light of the findings stated in the opinion of the court of appeals or in the opinion of the district court if not contradicted or rejected by the court of appeals. We make no attempt to resolve the controversy regarding the underlying facts."

In that sentence Securities and Exchange counsel unequivocally expresses his acceptance of the findings of the court of appeals and asserts that he intends to be bound by them. Then unaccountably, he proceeds to disagree with the findings of the court of appeals for the remainder of his brief. Parroting the palaver of petitioners' brief rather than consulting the record, Securities and Exchange counsel alleges first that the respondents Gale and Haslem employed a device or scheme to defraud in violation of 10b-5. However, the court of appeals found:

> "The record does not support the trial court's finding of a conspiracy, plan or scheme to violate any duties owed to the plaintiffs by any of the defendants. The trial court was in error in so finding." *Reyos v. United States, et al*, 431 F.2d 337 (10th Cir. 1970).

Securities and Exchange counsel says:

> "We make no attempt to resolve the controversy regarding the underlying facts."

and then attempts to controvert the findings of the appellate court and adopts the alleged facts proclaimed by the petitioners.

In a complete disavowal of the findings of the court of appeals, which he pretends to respect, Securities and Exchange counsel characterizes the respondents' relationship with the individual petitioners as being of such a fiduciary nature as to impose liability on the Bank. The appellate court found otherwise, and its decision is well supported by the law.

The sole and only source of the duties which the Bank had with respect to the petitioners, if any, must be the contract between the Bank and the Ute Distribution Corporation (A. 13). That contract is the one by which the Bank undertook the responsibility of being the transfer agent, depository and bookkeeper to the Ute Distribution Corporation. The contract did not provide for the Bank to assume any responsibility whatsoever with respect to the individual stockholder of Ute Distribution Corporation except to process the transfer of his shares of stock as the transfer agent of the corporation.

The issue raised is simple but vital and far-reaching and the trial court's unwarranted conclusions and decision would have shaken the very foundations of contract, corporate, bank and trust law. The basic question is: When a party enters into a contract with a corporation —not with its stockholders—, to what extent does it assume duties for the welfare and protection of the individ-

ual stockholder when the contract itself does not specify any such duties?

There is not a single word in the entire contract which obligates the Bank or its agents to perform the services for the individual stockholder which the trial court attempted by its conclusions of law to impose on the Bank. The trial court attempted to rewrite the contract.

The law to the effect that when a party enters into a contract with a corporation it does not enter into a contract with the corporation's stockholders is so elementary it is difficult to find cases implementing it.

> "The contract of a corporation is the contract of the legal entity, and not of the stockholders individually. 'Whenever a corporation makes a contract, it is the contract of the legal entity; of the artificial being created by the charter; and not the contract of the individual members.'" 1 Fletcher Cyclopedia Corporations §29, p. 126. *The Bank of Augusta v. Earl*, 10 L.Ed.274; *Benjamin Franklin Realty & Holding Co.*, 43 F.2d 337; *In re Luckenbach's Estate*, 261 N.Y.S.2d 106; *Grosslight v. Butts*, 141 N.W.2d 657; and *North Gate Corp. v. National Food Stores, Inc.*, 140 N.W.2d 744.

The law is well established that there is no fiduciary relationship between a corporation and its stockholders, so certainly there would be no fiduciary relationship between a contractee of a corporation and the stockholders of that corporation.

> "There is no fiduciary relation between shareholder and corporation, such as is found in all express trusts. Shareholder and corporation are at liberty to contract with each other without restriction, and *neither owes the other any extra-*

> *ordinary degree of good faith.*" Bogert, Trusts & Trustees, 2d Ed., §16, p. 90. (Emphasis supplied).

Therefore, there is no fiduciary relationship between the Ute Distribution Corporation and its shareholders, the petitioners in this action. The Bank, contracting with the Ute Distribution Corporation to be its transfer agent, depository and business advisor, was at most an agent or independent contractor of the corporation performing corporate functions for the Ute Distribution Corporation. Certainly if the corporation itself has no fiduciary relationship with the mixed bloods and did not owe them any "extraordinary degree of good faith," then the Bank did not have any type or degree of fiduciary relationship with them and owed no special, peculiar duty of good faith.

The fact that the Bank was a transfer agent, depository and bookkeeper, or even a "business advisor" in the language of the petitioners, did not thrust on Gale or Haslem or any of the Bank's trust department or any other officer, agent or employee of the Bank any type or degree of fiduciary relationship with the stockholders. The Bank was not even in a fiduciary relationship with the Ute Distribution Corporation. It was simply a contracting party, which gave rise to no type of trust relationship.

> "While one does not enter into a contract with another unless he trusts and has confidence in him, contract and debt amount to a business and not to a fiduciary relationship. . . . There is no rule that parties to a contract may not freely act for their own interests during the execution of the contract." Bogert, Trusts & Trustees, 2d Ed., §17, pp. 107-8.

Obviously, if the December 31, 1958 contract did not render the Bank a fiduciary of the corporation, it was not made a fiduciary of its stockholders. In Paragraph 15 of the trial court's Conclusions of Law (A. 536) the court states:

> "15. The Bank occupied toward the mixed-blood Indians not coming within the express provisions of the trust if not the position of a fiduciary in the strict sense at least a duty to deal with and for the mixed-bloods in good faith and lawfully and without purpose of overreaching or imposition."

In that paragraph, the trial court tried to establish some kind of fuzzy, incomprehensible, semi-fiduciary, quasi-guardian, nearly-but-not-quite-trustee relationship. The court's concept created a gray legal landscape where it is impossible to make out legal responsibilities. The court projected a new body of law—the law of the "semi-fiduciary." In this case it would impose responsibilities on a corporate-contractee for the benefit of the corporate stockholders where there was no trust or fiduciary relationship contemplated by the contract and the stockholder gave no consideration whatsoever in exchange for the onerous and detailed duties imposed on the contractee in the stockholders' behalf. The nearly-but-not-quite-trustee theory could introduce nothing but confusion into the law. A party is either a fiduciary or he isn't. One is a trustee or one is not, and to impose fiduciary-trustee status on a bank under this set of circumstances forces a bank to forego even being a simple transfer agent for such an organization. If a transfer agent and business advisor to a corporation must investigate the adequacy of the compensation paid to a stockholder

for each share of stock he sells, it can't be expected to do it for a fifty cent notary or one dollar certificate transfer fee. It must hire a squad of trained investigators to analyze the market, interview each selling stockholder and stock buyer, examine the seller's social worker's file and available I.Q. tests, make an appraisal of the corporation's pie-in-the-sky assets and if the consideration paid for the stock is something other than cash, make such appraisal as is necessary to determine its actual value. Such is the ridiculous and impractical responsibility the trial court would impose on the Bank in this case.

As a matter of fact, it appears that the Bank was the only organization involved which really tried to assist and protect the Indians. That is evidenced by the fact that it was the letter of Mr. Cowan, Trust Officer of the Bank, which upon approval by the Government and the Ute Distribution Corporation, set up the procedure which was designed to protect the sellers (Ex. FD, A. 131). Then it was agreed that it was the responsibility of the Government, not the Bank, to check, investigate and "verify the regularity" of the affidavits signed by the mixed bloods.

In the minutes of the board of directors of Ute Distribution Corporation of November 14, 1963 (Ex. 58, A. 70), this sentence appears:

> "It is the responsibility of the Superintendent to be sure the affidavit is true."

When Mrs. Sixkiller was asked about that, she testified as follows:

> "Q. One other sentence, the last sentence of that paragraph: 'It is the responsibility of the

superintendent to be sure the affidavit is true.' Who is meant by the superintendent?

A. The Superintendent of the Uintah and Ouray agency.

Q. Do you remember the discussion that surrounded that, and why that sentence was put in the minutes?

A. Yes.

Q. Would you tell us, please?

A. We had notice—just like above here—and then taking cars and stating that they had received cash.

Q. Do you recall who said it was the responsibility of the superintendent to be sure the affidavit was true? Was that the consensus of the opinion of the board of directors?

A. Mr. Morris, our attorney.

Q. What?

A. Our attorney and the board's opinion." (A. 339).

The Ute Distribution Corporation wrote a letter to Superintendent Zollar asking him to initiate an investigation into the matter of Ute Distribution stock sales, but the Ute Distribution Corporation received no answer or response to the request (A. 335).

In its relationship with the Bank, the Government took the responsibility of investigating the truthfulness and regularity of the affidavits. After presumably doing so, when it sent in the stock powers to the Bank authorizing the Bank to make the stock transfers, its letters always contained the following words:

"An affidavit of each of the above named sellers is on file in this office to the effect that the sum asked for the shares offered and posted has been received."

The court's findings of fact with respect to each of the petitioners verifies this fact, together with the fact that the Bank did not transfer a single share until it had received that certification from the Superintendent to the effect that the required procedure had been complied with (A. 295, 475, 479, 480, 482, 483, 485, 488, 490, 491, 492, 493, 495, 496,, 497, 517, 518).

After the Bank received the certification from the Superintendent informing the Bank that the stock had been offered "in accordance with the law and regulations of the Secretary . . . and there had been no acceptance of said offer," along with the letter that the affidavit to the effect that the Indian had received the sum for which the shares were offered and posted was on file, the Bank, as transfer agent, was legally bound to transfer the stock. If the Bank had refused to do so it would have been subject to suit by and liability to either the seller or buyer of the stock.

Francis T. Christy in his extensive work, *Transfer of Stock*, 3rd Ed. (1960), states in Chapter 5, Sec. 36:

"A stockholder has an inherent right to transfer his stock just as he has an inherent right to transfer any other property he may own. One of the incidents of the ownership of property is the power to dispose of it at pleasure. Hence, 'the courts have jealously guarded facilities for the transfer of title, and all unreasonable attempts to restrain the right to pass title have been declared void as against public policy.' 'Stock in a corporation held by an individual is his own private prop-

erty, which he may sell or dispose of as he sees proper, and over which neither the corporation nor its officers have any control. It is the subject of daily commerce and is bought and sold in the market like any other marketable commodity, . . .'"

The court of appeals was correct in its finding that the Bank did not violate any duty owed to the petitioners.

We do not argue with the holding of this Court in *Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, nor with the case of *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167 (2nd Cir.). They are not applicable in the case at bar because they involve fiduciary situations, and such fiduciary situations do not exist in the case at bar.

The court of appeals did find a possibility of liability on the part of the respondents Gale and Haslem, and consequently the Bank with respect to the situation where Gale or Haslem:

(1) Purchased stock from a petitioner; and

(2) Resold promptly at a profit; and

(3) Failed to disclose to the seller that he could sell at a higher price than they were paying or they made a misrepresentation by claiming that their offer was the prevailing price.

But, said the court of appeals, before that fact situation imposes liability, one additional fact must be proved: That the petitioner seller *relied* on the nondisclosure or misrepresentation. The court of appeals found there was no evidence of such reliance.

On that issue of reliance, the Securities and Exchange Commission may legitimately debate with the court of appeals. If the Securities and Exchange Commission desires to repeal the law of proximate cause, eliminate any necessity of proof of reliance and simply assume reliance when a misstatement is made, the writer will grant the Securities and Exchange Commission has some encouragement in the case of *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 483, which the Securities and Exchange Commission cites in its brief. It is arguable that the *Mills* case might be applicable to the fact situation surrounding *one* of the twelve petitioners in this case, to-wit: Petitioner, Glen Reed. He is the only petitioner with respect to whom the record reveals:

(1) A respondent (Gale) purchased stock from him (5 shares at $350 a share);

(2) Respondent sold same at a profit ($530 a share);

(3) Respondent failed to disclose to Reed that he, Gale, could resell at a profit, or it may also be inferred that he misrepresented the market by allegedly informing Reed that he was paying the prevailing price.

With respect to the other eleven petitioners, only two of them sold stock to Gale or Haslem, and there was no evidence that Gale or Haslem made a profit on their stock, that they failed to disclose an intended resale or that the prevailing price was any higher than the price they paid.

Now, if the nondisclosure or misrepresentation in the Reed instance was material, then under the Securities and Exchange Commission and petitioners' theory,

allegedly supported to some degree by the *Mills* case, reliance would be assumed, and Gale would be liable to Reed for the amount of his profit on the five shares, to-wit: $900.

But even the *Mills* case does not definitely decide the Reed case. There are non-analogous factors that keep the shoe from fitting. Those factors are twofold:

(1) In the *Mills* case which involved a misrepresentation to multiple stockholders with respect to the virtues of a merger, there is no affirmative evidence that the many victimized stockholders did *not* rely on the misrepresentation. In the case at bar, there is affirmative evidence that Reed did *not* rely; that is, there is affirmative evidence that Gale's nondisclosure or misrepresentation was not the proximate cause of the sale by Reed and it appears that Reed would have sold to Gale even if Gale had revealed to him that he was going to sell it to someone else at a higher price, to-wit: Reed testified he was "happy to get the money" (A. 172) and even though he thought the shares were worth $500 apiece, he readily sold at $350 (A. 173).

(2) In the few cases where reliance has been considered unnecessary, multitudinous plaintiffs were involved (usually a stockholders derivative action or an omission of a material fact, or both.) As in *Mills, supra,* 396 U.S. at 382, n. 5, in those cases where large numbers of plaintiffs are involved or a material omission is the culprit complained of, a showing of reliance would be impossible. As a result, in order to provide members of a class with meaningful relief, the courts have permitted the concept of reliance to merge into the concept of materiality.

The *Mills* case is typical of those cases in which a class of persons seeks relief in the form of declaratory judgment or injunction. However, in cases such as the one now before the court, where plaintiff seeks relief in the form of damages and he is the one who claims to have been injured by the alleged violation of the rule by the defendant, he then should be obligated to show reliance and causation in order to recover, because a mere showing of the violation of the rule would be meaningless without a causal connection.

In those cases where proof of reliance is within the reach of plaintiffs, the courts have continued to apply that requirement. In *Mitchell v. Texas Gulf Sulphur*, ... F.2d ...., CCH Fed, Sec. L. Rep. ¶93,019 (10th Cir., April 26, 1970), three plaintiffs sued Texas Gulf Sulphur for violation of Rule 10b-5 based upon a misleading press release. The trial court granted judgments in favor of all three, but the court of appeals reversed as to one of the plaintiffs who sold five days after a correcting press release was issued, ruling that he had no right to rely on the first release when the corrective release had been issued.

And in a related case arising out of the same factual situation, the Second Circuit stated (*SEC v. Texas Gulf Sulphur*, 401 F.2d 833 at 860 (2d Cir., 1968)):

> "Therefore it seems clear from the legislative purpose Congress expressed in the Act, and the legislative history of Section 10(b) that Congress when it used the phrase 'in connection with the purchase or sale of any security' intended only that the device employed, whatever it might be, be of a sort *that would cause reasonable investors to rely thereon*, and, in connection therewith, *so*

> *relying*, cause them to purchase or sell a corporation's securities . . ." (Emphasis supplied).

In those cases where money damages are not sought and proof of reliance is so difficult as to be virtually impossible, the courts are justified in examining materiality of the facts involved and in considering a merger of the materiality and the causation. However, in those cases where plaintiffs seek damages, reliance should continue to be an element of proof, *particularly in cases such as the one before the Court, where the plaintiffs themselves testified, and it would be patently simple for them by their testimony to reveal whether they had or had not relied on representations made by the defendants or would have acted otherwise had they not been subjected to a nondisclosure.*

That appears to the writer to be the most significant distinction between the case at bar and cases such as the *Mills* case. In the class action cases involving hundreds of plaintiffs, it is impracticable for them to testify with respect to causation and reliance. Consequently, it is impossible to ascertain factually whether or not they did actually rely. Petitioners in this case suffered no such disability. *They did testify, but none of them claimed that they had relied on any representations made by the respondents, and none of them stated that they would not have sold the stock had they been informed that the buyers (the respondents) could sell the shares at a higher price. All their lawyers had to do was ask them and they would have testified one way or the other.* The language of the court of appeals itself answers the argument of the petitioners on this point:

> "The plaintiffs allege that certain acts and statements of the defendants were directed to them or were the proximate cause of their damages. Thus the causal connection must be established—that in fact the loss resulted from defendants' acts—a simple and fundamental proposition in such actions for private damages. The plaintiffs' argument refers to several cases where the proceedings were brought by the SEC for enforcement. The matter of reliance was not there considered, but these are from an entirely different position." ***Reyos v. United States***, et al, 431 F.2d 1337 (10th Cir., 1970).

The court of appeals was clearly justified in requiring evidence of reliance in this case and in finding no such evidence in the record.

CONCLUSION

Respondents First Security Bank of Utah, N.A., Gale and Haslem respectfully urge the Court to sustain the verdict of the Circuit Court of Appeals with respect to those three respondents.

Respectfully submitted,

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CERTIFICATE OF MAILING

I, MARVIN J. BERTOCH, hereby certify that I mailed, postage prepaid, three copies of the foregoing Reply of Respondents, First Security Bank of Utah, N.A., John B. Gale and Verl Haslem to the Amicus Curiae Brief of the Securities and Exchange Commission, to the attorneys listed below at the addresses below on the 11th day of October, 1971:

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